RELEVANT TO ACCA QUALIFICATION PAPER F6 (UK) AND PERFORMANCE OBJECTIVES 19 AND 20

# Chargeable gains, part 2

*This two-part article is relevant to candidates sitting the Paper F6 (UK) exam in 2012, and is based on tax legislation as it applies to the tax year 2011–12 (Finance Act 2011). Part one of this article is available here.*

Question three of Paper F6 (UK) focuses on chargeable gains in either a personal or a corporate context, and is worth 15 marks. A small element of chargeable gains may also be included in any of the other questions.

## PERSONAL CHARGEABLE GAINS

### Shares

The disposal of shares can create a particular problem. This is because the shares disposed of might have been purchased at different times, and it is then difficult to identify exactly which shares have been sold. Disposals of shares are matched with purchases in the following order:

- Shares purchased on the same day as the disposal.
- Shares purchased within the following 30 days.
- Shares in share pool.

The share pool aggregates all purchases made up to the day of the disposal.

---

### EXAMPLE 1

Ivy has had the following transactions in the shares of Jing plc:

| | |
|---|---|
| 1 June 2004 | Purchased 4,000 shares for £6,200. |
| 30 April 2009 | Purchased 2,000 shares for £8,800 |
| 15 July 2011 | Purchased 500 shares for £2,500 |
| 15 July 2011 | Sold 4,500 shares for £27,000 |

Ivy's chargeable gain for 2011–12 is as follows:

| | £ | £ |
|---|---|---|
| **Purchase 15 July 2011** | | |
| Disposal proceeds (27,000 x 500/4,500) | 3,000 | |
| Cost | (2,500) | |
| | | 500 |
| **Share pool** | | |
| Disposal proceeds (27,000 x 4,000/4,500) | 24,000 | |
| Cost | (10,000) | |
| | | 14,000 |
| | | 14,500 |

**Share pool**

| | Number | Cost |
|---|---|---|
| | **£** | **£** |
| Purchase 1 June 2004 | 4,000 | 6,200 |
| Purchase 30 April 2009 | 2,000 | 8,800 |
| | 6,000 | 15,000 |
| Disposal 15 July 2011 (15,000 x 4,000/6,000) | (4,000) | (10,000) |
| Balance carried forward | 2,000 | 5,000 |

*The disposal is first matched with the same day purchase and then against the share pool.*

---

The reason that disposals are matched with shares purchased within the following 30 days is to prevent a practice known as bed and breakfasting. A person might sell shares at the close of business one day and then buy them back at the opening of business the next day. Previously, a chargeable gain or a capital loss could thus be established without a genuine disposal being made. The 30-day matching rule makes bed and breakfasting much more difficult, since the subsequent purchase cannot take place within 30 days.

---

**EXAMPLE 2**

Keith purchased 1,000 shares in Long plc on 5 July 2011 for £10,000. The shares have fallen in value, so he would like to establish a capital loss. Therefore the shares were sold on 2 December 2011 for £2,000, and purchased back on 10 December 2011 for £1,900.

Keith's transactions are caught by the 30-day matching rule. The disposal on 2 December 2011 will be matched with the purchase on 10 December 2011, and so for 2011–12 he will have a chargeable gain of £100 (2,000 – 1,900).

---

With individuals it might be necessary to establish a market value figure where the shares are disposed of by way of a gift rather than being sold.

---

**EXAMPLE 3**

Maude made a gift of her entire shareholding of 10,000 £1 ordinary shares in Night plc to her daughter. On the date of the gift the shares were quoted at £5.10 – £5.18, with recorded bargains of £5.00, £5.15 and £5.22.

- The shares in Night plc are valued at the lower of the quarter up price (£5.10 + ¼(£5.18 – £5.10) = £5.12) and the average of the days highest and lowest bargains ((£5.00 + £5.22)/2 = £5.11).
- The deemed proceeds figure is therefore £51,100 (10,000 x 5.11).

With a bonus issue there is no additional cost involved. The only thing that changes is the number of shares held.

---

**EXAMPLE 4**

On 22 January 2012 Oliver sold 30,000 £1 ordinary shares in Pink plc for £140,000. Oliver had purchased 40,000 shares in Pink plc on 9 February 2010 for £96,000. On 3 April 2011 Pink plc made a 1 for 2 bonus issue.

Oliver's chargeable gain for 2011–12 is as follows:

| | **£** |
|---|---|
| Disposal proceeds | 140,000 |
| Cost | (48,000) |
| | 92,000 |

*Oliver was issued with 20,000 (40,000 x 1/2) new ordinary shares as a result of the bonus issue.*

*The cost of the shares sold is therefore £48,000 (96,000 x 30,000/(40,000 + 20,000)).*

---

With a rights issue the new shares are paid for, and so the cost figure will have to be adjusted.

---

**EXAMPLE 5**

On 22 January 2012 Quinn sold 30,000 £1 ordinary shares in Red plc for £140,000. Quinn had purchased 40,000 shares in Red plc on 9 February 2009 for £100,000. On 3 May 2011 Red plc made a 1 for 2 rights issue. Quinn took up her allocation under the rights issue in full, paying £3.00 for each new share issued.

Quinn's chargeable gain for 2011–12 is as follows:

| | **£** |
|---|---|
| Disposal proceeds | 140,000 |
| Cost | (80,000) |
| | 60,000 |

*Quinn was issued with 20,000 (40,000 x 1/2) new ordinary shares under the rights issue at a cost of £60,000 (20,000 x £3.00).*

*The cost of the shares sold is therefore £80,000 (100,000 + 60,000 = 160,000 x 30,000/(40,000 + 20,000)).*

A paper for paper takeover or reorganisation is not a chargeable disposal. The new shares simply take the place of the original shares, and are deemed to have been purchased at the same time and for the same cost. Where more than one class of new share is acquired as a result of the takeover/reorganisation, the original cost is apportioned according to the market values of the new shares immediately after the takeover/reorganisation.

**EXAMPLE 6**

On 28 March 2012 Rita sold her entire holding of £1 ordinary shares in Sine plc for £55,000. Rita had originally purchased 10,000 shares in Sine plc on 5 May 2009 for £14,000. On 7 August 2010 Sine plc had a reorganisation whereby each £1 ordinary share was exchanged for two new £1 ordinary shares and one £1 preference share. Immediately after the reorganisation each £1 ordinary share in Sine plc was quoted at £2.50 and each £1 preference share was quoted at £1.25.

Rita's chargeable gain for 2011–12 is as follows:

| | **£** |
|---|---:|
| Disposal proceeds | 55,000 |
| Cost | (11,200) |
| | 43,800 |

*On the reorganisation Rita received new ordinary shares valued at £50,000 (2 x 10,000 x £2.50) and preference shares valued at £12,500 (10,000 x £1.25).*

*The cost attributable to the ordinary shares is £11,200 (14,000 x 50,000/(50,000 + 12,500).*

Where cash is received on a takeover then the normal disposal rules will apply.

**EXAMPLE 7**

Cherry purchased 12,000 £1 ordinary shares in Alphabet Ltd on 27 July 2004 for £23,900. On 15 July 2011 Alphabet Ltd was taken over by ABC plc, and Cherry received £6 for each of her shares in that company.

Cherry's chargeable gain for 2011–12 is as follows:

| | **£** |
|---|---:|
| Disposal proceeds (12,000 x £6) | 72,000 |
| Cost | (23,900) |
| | 48,100 |

Where a takeover is partly for shares and partly for cash then the part disposal rules will apply.

---

**EXAMPLE 8**

Richard purchased 10,000 £1 ordinary shares in Split plc on 21 July 2008 for £23,100. On 28 August 2011 Split plc was taken over by Combined plc. For each of his £1 ordinary shares in Split plc, Richard received two £1 ordinary shares in Combined plc plus £2.50 in cash. Immediately after the takeover Combined plc's £1 ordinary shares were quoted at £4.00.

Richard's chargeable gain for 2011–12 is as follows:

| | £ |
|---|---|
| Disposal proceeds (10,000 x £2.50) | 25,000 |
| Cost | (5,500) |
| | 19,500 |

*On the takeover Richard received new ordinary shares valued at £80,000 (2 x 10,000 x £4.00) and cash of £25,000.*

*The cost attributable to the cash element is £5,500 (23,100 x 25,000/(25,000 + 80,000).*

---

**Rollover relief**
Rollover relief allows a chargeable gain to be deferred (rolled over) where the disposal proceeds of the old asset are reinvested in a new asset. The deferral is achieved by deducting the chargeable gain from the cost of the new asset.

To qualify for rollover relief both the old asset and the new asset must be qualifying assets. The most relevant types of qualifying asset as far as Paper F6 (UK) is concerned are:

- Land and buildings
- Fixed plant and machinery
- Goodwill

It is not necessary for the old asset and the new asset to be in the same category.

---

**EXAMPLE 9**

What are the conditions that must be met in order that rollover relief can be claimed?

- The reinvestment must take place between one year before and three years after the date of disposal.

- The old and new assets must both be qualifying assets and be used for business purposes.
- The new asset must be brought into business use at the time that it is acquired.

---

Where the disposal proceeds of the old asset are not fully reinvested in the new asset, the amount not reinvested reduces the amount of chargeable gain that can be rolled over. Therefore if the amount not reinvested is greater than the chargeable gain no rollover relief is available.

Where the new asset is a depreciating asset, then the gain does not reduce the cost of the new asset but is instead held over. A depreciating asset is an asset with a predictable life of less than 60 years. The only types of depreciating asset that you need to be aware of are fixed plant and machinery and short leaseholds.

---

**EXAMPLE 10**

Violet sold a factory on 15 August 2011 for £320,000, and this resulted in a chargeable gain of £85,000. She is considering the following alternative ways of reinvesting the proceeds from the sale of her factory:

- A freehold warehouse can be purchased for £340,000.
- A freehold office building can be purchased for £275,000.
- A leasehold factory on a 40-year lease can be acquired for a premium of £350,000.
- A freehold factory can be purchased for £230,000.

The reinvestment will take place during November 2011.

**Freehold warehouse**
- The sale proceeds are fully reinvested, and so the whole of the chargeable gain can be rolled over.
- The base cost of the warehouse will be £255,000 (340,000 – 85,000).

**Freehold office building**
- The sale proceeds are not fully reinvested, and so £45,000 (320,000 – 275,000) of the chargeable gain cannot be rolled over.
- The base cost of the office building will be £235,000 (275,000 – (85,000 – 45,000)).

**Leasehold factory**
- The sale proceeds are fully reinvested, and so the whole of the chargeable gain can be held over.
- The factory is a depreciating asset, and so the base cost of the factory is not adjusted.

- The chargeable gain is held over until the earlier of November 2021 (ten years from the date of acquisition), the date that the factory is sold, or the date that it ceases to be used in the business.

**Freehold factory**

- No rollover relief is available as the amount not reinvested of £90,000 (320,000 – 230,000) exceeds the chargeable gain.
- The base cost of the factory will remain at £230,000.

---

When the asset disposed of was not used entirely for business purposes then the proportion of the chargeable gain relating to the non-business use does not qualify for rollover relief.

---

**EXAMPLE 11**

Willow sold a freehold factory on 8 November 2011 for £146,000, and this resulted in a chargeable gain of £74,000. The factory was purchased on 15 January 2009. 75% of the factory had been used for business purposes by Willow as a sole trader, but the other 25% was never used for business purposes. Willow purchased a new freehold factory on 10 November 2011 for £156,000.

Willow's chargeable gain for 2011–12 is as follows:

| | £ |
|---|---:|
| Gain | 74,000 |
| Rollover relief (74,000 – 18,500) | (55,500) |
| | 18,500 |

*The proportion of the chargeable gain relating to non-business use is £18,500 (74,000 x 25%), and this amount does not qualify for rollover relief.*

*The sale proceeds are fully reinvested, and so the balance of the gain can be rolled over.*

*The base cost of the new factory is £100,500 (156,000 – 55,500).*

---

**Holdover relief**

Holdover relief allows a chargeable gain to be deferred (held over) when a gift is made of a qualifying business asset. The deferral is achieved by deducting the chargeable gain of the donor who has made the gift from the base cost of the donee who has received the gift.

Holdover relief is also available when a sale is made at less than market value. In this case there will be an immediate charge to capital gains tax (CGT) where the sale proceeds exceed the original cost of the asset.

For Paper F6 (UK) the most relevant types of qualifying business asset are as follows:

- Assets used for trade purposes by a sole trader.
- Shares in a personal company (where the individual has at least a 5% shareholding).
- Shares in unquoted trading companies.

Remember that the market value of an asset is used rather than the actual proceeds when a gift is made between family members since they will be connected persons.

---

**EXAMPLE 12**

On 15 August 2011 Xia sold 10,000 £1 ordinary shares in Yukon Ltd, an unquoted trading company, to her daughter for £75,000. The market value of the shares on that date was £110,000. The shareholding was purchased on 10 July 2010 for £38,000. Xia and her daughter have elected to hold over the gain as a gift of a business asset.

Xia's chargeable gain for 2011–12 is as follows:

| | £ |
|---|---|
| Deemed proceeds | 110,000 |
| Cost | (38,000) |
| | 72,000 |
| Holdover relief (72,000 – 37,000) | (35,000) |
| | 37,000 |

*Xia and her daughter are connected persons, and therefore the market value of the shares sold is used.*

*The consideration paid for the shares exceeds the allowable cost by £37,000 (75,000 – 38,000). This amount is immediately chargeable to CGT.*

---

Where the disposal consists of shares in a personal company, holdover relief will be restricted if the company has chargeable non-business assets.

---

**EXAMPLE 13**

On 5 October 2011 Zia made a gift of her entire holding of 20,000 £1 ordinary shares in Apple Ltd, a personal company, to her daughter. The market value of the shares on that date was £200,000. The shares had been purchased on 1 January 2011 for £140,000. On 5 October 2011 the market value of Apple Ltd's chargeable assets was £150,000, of which £120,000 was in respect of chargeable business assets. Zia and her daughter have elected to hold over the gain as a gift of a business asset.

Zia's chargeable gain for 2011–12 is as follows:

| | £ |
|---|---|
| Deemed proceeds | 200,000 |
| Cost | (140,000) |
| | 60,000 |

| | |
|---|---|
| Holdover relief | (48,000) |
| | 12,000 |

*Holdover relief is restricted to £48,000 (60,000 x 120,000/150,000), being the proportion of chargeable assets to chargeable business assets.*

---

**The transfer of a business to a limited company**
Rollover relief is available when an unincorporated business is incorporated. For relief to be available all the assets of the unincorporated business must be transferred to the new limited company in exchange for a consideration that must be wholly or partly in the form of shares.

The deferral is achieved by deducting the chargeable gains arising on the disposal of the assets of the unincorporated business from the value of the shares received from the new limited company.

Where some of the consideration is in the form of cash or a loan, then that proportion of the chargeable gains cannot be rolled over.

---

**EXAMPLE 14**

On 8 August 2011 Bua incorporated a business that she had run as a sole trader since 1 March 2007. The market value of the business on 8 August 2011 was £250,000. All of the business assets were transferred to a new limited company, with the consideration consisting of 200,000 £1 ordinary shares valued at £200,000 and £50,000 in cash. The only chargeable asset of the business was goodwill, and this was valued at £100,000 on 8 August 2011. The goodwill had a nil cost.

Bua's chargeable gain for 2011–12 is as follows:

| | £ |
|---|---|
| Disposal proceeds | 100,000 |
| Cost | (Nil) |
| | 100,000 |
| Rollover relief (100,000 – 20,000) | (80,000) |
| | 20,000 |

*The proportion of the chargeable gain relating to the cash consideration cannot be rolled over, so £20,000 (100,000 x 50,000/250,000) of the gain is immediately chargeable to CGT.*

---

**In the exam**
- A question may ask you to just calculate a person's chargeable gains or taxable gains rather than their CGT liability. If this is the case then do not waste time calculating the liability, as there will be no marks for doing so.

- Make sure you identify any exempt disposals so that you do not waste time performing unnecessary calculations.
- A question may tell you that a certain relief is not available for a particular disposal. Make a careful note of such guidance or you will waste time and might also lose marks as well.
- An unincorporated business is not treated as a separate entity for CGT purposes. Therefore, when a business is disposed of you should deal with each asset separately.
- Do not forget to deduct the annual exempt amount.
- When dealing with shares it is important to look carefully at the dates to see if same day or 30-day matching is applicable.
- It is important to establish how much of a person's basic rate tax band is available. Remember that a taxable income figure is **after** the personal allowance has been deducted.

---

**EXAMPLE 15**

On 13 July 2011 Dear sold 1,000 of her 3,000 £1 ordinary shares in XYZ plc for £6,600. She died on 5 April 2012, and the remaining 2,000 shares were inherited by her daughter. On that date these shares were valued at £15,600. The holding of 3,000 shares had been purchased on 20 June 2004 for £4,800.

- There is no CGT liability on the sale of the XYZ plc shares as the gain of £5,000 (6,600 – (4,800 x 1,000/3,000)) is less than the annual exempt amount *(note that it should be obvious that where sales proceeds are just £6,600 then there is no CGT liability).*
- The transfer of the XYZ plc shares on Dear's death is an exempt disposal.

---

## CORPORATE CAPITAL GAINS

**Overview**
You have seen how individuals are subject to CGT. Although there are a lot of similarities in the way in which the chargeable gains of a limited company are taxed, there are also some very important differences:

- A limited company's chargeable gains form part of the taxable total profits. They are not taxed separately.
- The annual exempt amount is not available.
- Indexation allowance is given when calculating chargeable gains for a limited company.
- Limited companies can only benefit from rollover relief, and this is applied after taking account of any indexation allowance. They cannot benefit from entrepreneurs' relief, holdover relief for the gift of business assets or for rollover relief upon incorporation.

**Basic computation**
The basic computation for a limited company is virtually the same as for an individual. However, you may also be expected to calculate the indexation allowance:

- The indexation allowance is given from the month of acquisition up to the month of disposal.
- The indexation factor is normally rounded to three decimal places.
- The indexation allowance cannot be used to create or increase a capital loss.
- Because the indexation allowance is not available in respect of the incidental costs of disposal, it is necessary to show these separately in the computation.

---

**EXAMPLE 16**

Delta Ltd sold a factory on 15 February 2012 for £360,000. The factory was purchased on 24 October 1995 for £164,000, and was extended at a cost of £37,000 during March 1997.

Delta Ltd incurred legal fees of £3,600 in connection with the purchase of the factory, and legal fees of £6,200 in connection with the disposal. Retail price indices (RPIs) are as follows:

| | |
|---|---|
| October 1995 | 149.8 |
| March 1997 | 155.4 |
| February 2012 | 240.0 |

| | | £ | £ |
|---|---|---|---|
| Disposal proceeds | | | 360,000 |
| Incidental costs of disposal | | | (6,200) |
| | | | 353,800 |
| Cost | | 164,000 | |
| Incidental costs of acquisition | | 3,600 | |
| | | 167,600 | |
| Enhancement expenditure | | 37,000 | (204,600) |
| | | | 149,200 |
| Indexation | – Cost 167,600 x 0.602 | 100,895 | |
| | – Enhancement 37,000 x 0.544 | 20,128 | |
| | | | (121,023) |
| | | | 28,177 |

The indexation factor for the cost is 0.602 (240.0 – 149.8)/149.8, and for the enhancement expenditure it is 0.544 (240.0 – 155.4)/155.4.

---

When a limited company has a capital loss, it is first set off against any chargeable gains arising in the same accounting period. Any remaining capital loss is then carried forward and set off against the first available chargeable gains of future accounting periods.

Although chargeable gains are included as part of a company's taxable total profits, capital losses are never set off against other income.

---

**EXAMPLE 17**

Even Ltd has the following results:

| | Year ended 31 March 2011 | Year ended 31 March 2012 |
|---|---|---|
| | £ | £ |
| Trading profit/(loss) | 56,000 | (17,000) |
| Property business profit | 4,000 | 10,000 |
| Chargeable gain/(capital loss) | (8,000) | 85,000 |

The corporation tax liability of Even Ltd for the years ended 31 March 2011 and 2012 is as follows:

| | Year ended 31 March 2011 | Year ended 31 March 2012 |
|---|---|---|
| | £ | £ |
| Trading profit | 56,000 | – |
| Property business profit | 4,000 | 10,000 |
| Chargeable gain | – | 77,000 |
| | 60,000 | 87,000 |
| Loss relief | – | (17,000) |
| Taxable total profits | 60,000 | 70,000 |
| | | |
| Corporation tax at 21% | 12,600 | |
| Corporation tax at 20% | | 14,000 |

The capital loss for the year ended 31 March 2011 is carried forward, and so the chargeable gain for the year ended 31 March 2012 is £77,000 (85,000 – 8,000).

---

**Shares**

For limited companies, disposals of shares are matched with purchases in the following order:

- Shares purchased on the same day as the disposal.
- Shares purchased during the nine days prior to the disposal.
- Shares in the 1985 pool.

When calculating indexation allowances for the 1985 pool, the indexation fraction is not rounded to three decimal places.

---

**EXAMPLE 18**

On 15 June 2011 Fair Ltd sold 70,000 £1 ordinary shares in Gong plc for £340,000. Fair Ltd had originally purchased 40,000 shares in Gong plc on 10 June 1995 for

£110,000, and purchased a further 60,000 shares on 20 August 1999 for £180,000. Retail price indices (RPIs) are as follows:

| | |
|---|---|
| June 1995 | 149.8 |
| August 1999 | 165.5 |
| June 2011 | 235.0 |

**Chargeable gain**

| | £ |
|---|---|
| Disposal proceeds | 340,000 |
| Cost | (203,000) |
| | 137,000 |
| Indexation allowance (299,707 – 203,000) | (96,707) |
| | 40,293 |

**1985 Pool**

| | **Number** | **Cost** | **Indexed cost** |
|---|---|---|---|
| | | **£** | **£** |
| Purchase June 1995 | 40,000 | 110,000 | 110,000 |
| Indexation to August 1999 | | | |
| 110,000 x (165.5 – 149.8)/149.8 | | | 11,529 |
| | | | 121,529 |
| Purchase August 1999 | 60,000 | 180,000 | 180,000 |
| | 100,000 | 290,000 | 301,529 |
| Indexation to June 2011 | | | |
| 301,529 x (235.0 – 165.5)/165.5 | | | 126,624 |
| | | | 428,153 |
| Disposal June 2011 | | | |
| Cost x 70,000/100,000 | (70,000) | (203,000) | (299,707) |
| Balance carried forward | 30,000 | 87,000 | 128,446 |

**In the exam**

- Remember that limited companies are not entitled to the annual exempt amount.
- Remember that chargeable gains are part of a limited company's total taxable profits. They are not taxed separately.
- When dealing with shares it is important to look carefully at the dates to see if same day or nine-day matching applies.

**David Harrowven is examiner for Paper F6 (UK)**